Surface Transforms plc

Annual Report and Accounts

31 May 2003

Highlights

- Moved from Ofex to the AIM market and raised £1.3 million (£0.9 million net)
- Introduced new business model following strategic review in February 2003
- Successfully increased revenues from significantly lower cost base
- Increased turnover by 130% to £240,000 (*2002: £104,000*)
- Operating loss before tax of £1.13 million, with the second half losses falling to £333,000
- Partnership with world-leading aircraft brake systems manufacturer now producing regular monthly revenues
- Strengthened board with the appointments of two additional non-executive directors, both have experience of building profitable high technology businesses

Chairman's Statement

The Company has made good progress and has achieved some important milestones in its principal aerospace and automotive markets. Following a strategic review, the Company is now focussed on three core activities as it develops its proprietary carbon ceramic technologies. These are (1) knowledge based collaborative ventures with global commercial partners in aircraft braking and rocket propulsion materials. (2) contract development activity with commercial partners in the automotive and transportation markets where carbon fibre reinforced ceramic (CFRC) application opportunities abound; and (3) CFRC product sales.

Financial Results

Turnover for the year was 130% higher than the previous period at £239,755 (*2002: £104,063*). Operating losses for the year were £1,129,909 (*2002: £569,033 loss*) and these included non-recurring, exceptional costs associated with the write down of £293,048 of inventory relating to the change in the Company's approach to the Formula 1 automotive market. Operating losses before exceptional items were £836,861 (*2002: £569,033 loss*).

In February, the Board initiated a strategic review, which resulted in the substantial reduction of the Company's cost base in the second half of the year. Operating losses in the second half of the year reduced to £332,637 (full year 2003: £1,129,909 loss)

The Company's cash and working capital position has been stabilised since the year end; this has resulted from improved trading and the receipt of substantial R&D tax credits relating to the previous two years. The Company has no bank borrowings.

Operating Activities

Aircraft brakes

The collaborative partnership with a world-leading aircraft brake systems supplier continues to progress well and our partner has committed considerable financial and technical resources to the technical collaboration. In December 2002, the Company delivered the initial pilot plant on time and on budget. This plant is producing test brake materials for a yet-to-be-launched wide-bodied commercial jet airliner. Work is progressing on the full scale plant design and Surface Transforms is discussing important service and licence agreements with its partner which should underpin future income and long term licence payments if Surface Transforms's technology is ultimately adopted on the targeted aircraft.

Surface Transforms's materials are included in the test programme because of their weight-saving advantages over rival products. In the aerospace market small weight savings can produce substantial reductions in aircraft running costs, a crucial element in the decision-making process for all aircraft buyers. Surface Transforms's products have a considerable technical edge. As ever, shareholders should be aware that as with all new leading-edge technologies there are no guarantees that the Surface Transforms's technology will ultimately be adopted on the aircraft. Nevertheless, progress to date and the investment made by our partner is encouraging and indicates that Surface Transforms's product has applications as an economic solution for a variety of aircraft braking requirements.

Automotive markets

After the disappointment in December 2002 of the FIA rule change, stipulating one supplier only for the F1 brake market, the Company has sought to widen the market application opportunities it has with its proprietary CFRC technology.

Indy Racing and GT

In January 2003, we received our first order to supply development brake discs and pads from one of the most successful teams that competes in the Indy Car Racing League (IRL). The order, for the supply of brake discs and pads, has been delivered and the Company is working closely with the US distributor to evaluate the brake pad prototypes to market CFRC brakes to other IRL teams.

Entry to the GT car market has been recent and testing has commenced with two established GT racing teams, both of which have conducted a number of successful on-car tests and off-car assessments. This market is expected to have good potential for Surface Transforms over the longer term.

High Performance Cars

Surface Transforms is collaborating on developing and testing products with a leading international supplier of complete braking systems to a number of the car manufacturing majors. The Company's partner's sales are in both the OEM (original equipment manufacture) and the after markets.

Carbon Fibre Preforms

Several orders for carbon fibre preforms have been successfully completed and delivered satisfactorily to customers. The Company is now well-placed to push ahead for a greater penetration of this market. In preparation for a focused sales campaign, the needling plant has been relocated to a new, self-contained unit that is much better suited to production than the previous location. There is confidence that the personnel and resources are available to significantly increase the Company's share of the carbon preforms market.

Other market applications

Surface Transforms has been working since 2001 in development programmes to supply a bespoke rocket propulsion part to a division of BAe Systems, now called Roxel, since its recent merger. Testing on the lightweight rocket component continues to progress. The Company has recently been invited by Roxel to tender for a second programme requiring a different specification part to be supplied in CFRC material.

In the rail market, we have supplied the development partner SabWabco, the world's leading supplier of complete rail brake systems, with several full-scale rotors as part of a new programme for a lightweight rail project.

Work on products for two important and fast-growing new market applications for resin transfer moulding and ballistics is providing encouraging results, and demonstrates that our CFRC technology can be used more broadly in commercial contexts. We shall report on these in more detail as these development projects mature.

Directors and the Board

The expansion of the Company, the listing on AIM and the recently initiated Company-wide strategic review have ushered in a number of changes on the board designed to provide a platform for future expansion.

The executive directors are Julio Faria, Managing Director and Dr. Geoff Gould, Sales & Marketing Director. David Levis, Commercial Director, has expressed his intention to resign from the Company and pursue his other interests. His contribution to the Company over the past three years has been significant and we wish him well with his future career. We shall shortly be appointing a Financial Controller, with the intention that this is made a board appointment after an appropriate period.

Kevin D'Silva joined the board in March 2003 as a non-executive director. He has extensive strategic business experience in the public company sector and an excellent track record in the building of a fast-growing, profitable technological group. In April this year, Peter Holland joined the board as a non-executive director, and brought with him the scientific and marketing experience accumulated over 20 successful years in the chemical polymer processing and formulation business. David Williams left the board in April 2003 and returned to his Formula 1 career as an executive director in the Jordan team. I would like to place on record the thanks of all connected with the Group to David Williams.

After three years as Chairman, which saw Surface Transforms float successfully on Ofex and then move to AIM, I shall not be seeking re-election as director at the forthcoming Annual General meeting and the board has elected Kevin D'Silva to succeed me as Chairman. I shall continue to remain a shareholder and expect that the new senior managerial talent that has been introduced to the Company will progress the business through its next phases of expansion.

Outlook

Following the strategic review and the management and board changes, the Company has recently commenced the next phase of expansion, which will see our technology have broader commercial applications in our target markets. These will include additional commercial and military aircraft braking systems, rocket motor systems, clutch applications, high performance and GT cars and a number of other industrial and defence applications.

The prospects within the Company's chosen application markets have widened considerably this past calendar year, despite the disappointments in the Formula 1 market. The revised business model, focuses, alongside CFRC product sales, on collaborative and contract development of its CFRC technology with a larger range of clients. This strategy reduces over-dependence on a few large client projects, while at the same time improves cash inflow and application diversity, and over the longer term should lead to the greater commercial adoption of Surface Transforms's unique CFRC technology.

Derek Whitney
Chairman

8 September 2003

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 May 2003.

Principal activity

The principal activity of the company during the year was the development and manufacture of carbon fibre reinforced ceramic friction products.

Business review

A review of the company's activities during the year is dealt with in the Chairman's statement.

On 24 September 2002 the company's shares were admitted to trading on the London Stock Exchange's Alternative Investment Market.

Future developments

The Board aims to continue with its corporate strategy which is to exploit its technologies in Carbon Fibre Reinforced Ceramics (CFRC) by:

- establishing contract development opportunities with multi national customers in the automotive and defence industries;
- establish collaborative development opportunities with multi national clients in the aerospace, rail and defence industries;
- expand commercial sales of CFRC products.

Research and development

The majority of the company's staff are employed in research and development activities which is concentrated on the ongoing development of carbon ceramic friction materials for new products and applications.

Proposed dividend and transfer to reserves

The loss for the year after taxation amounted to £964,382 *(2002:£561,065 loss).* The directors do not recommend the payment of a dividend.

Policy and practice on payment of creditors

It is the company's policy that payments to suppliers are made in accordance with the terms and conditions agreed between the company and its suppliers, providing that all trading terms and conditions have been complied with. The company does not follow any code or standard on payment practice.

At the year ended, there were 14 days *(2002: 78 days)* purchases in trade creditors.

Political and charitable donations

The company made no political or charitable donations during the year *(2002: £nil)*.

Directors and directors' interests

The directors who held office during the year were as follows:

JJ Faria
Professor DT Clark*
DE Levis
Dr G Gould (appointed 16 July 2002)
DM Whitney (Chairman)
D Williams* (resigned 27 March 2003)
K D'Silva* (appointed 27 March 2003)
PJ Holland* (appointed 17 April 2003)

* denotes non-executive Director.

Kevin D'Silva and Peter Holland have been appointed as directors since the last annual general meeting, and retire in accordance with the articles of association and, being eligible, offer themselves for re-election. The directors retiring by rotation are Julio Faria who, being eligible offers himself for re-election and Derek Whitney who will not be seeking re-election.

The directors had the following interests in the ordinary shares of the company according to the register of directors' interests:

		Number of £0.01 ordinary shares	
	% of issued share capital	**Interest at end of year**	**Interest at start of year**
J J Faria	27.9	2,623,845	2,623,845
Prof DT Clark	10.9	1,024,661	1,024,661
DE Levis	7.2	676,332	676,332
DM Whitney	1.9	182,374	182,374
Dr G Gould	0.05	4,350	-
D Williams	1.77	166,245	166,245
K D'Silva	0.06	5,967	2,667
PJ Holland	0.11	10,758	10,758

The directors, along with selected employees, have been granted options over ordinary shares. Details of the directors' interests in options over ordinary shares are disclosed in the Report on directors' remuneration on page 8.

Substantial shareholders
Except for directors' interests noted above, the directors are aware of the following who are interested in 3% or more of the company's equity, as follows:

	Registered holding Number	**% of issued share** Capital
BNY (OCS) Nominees Limited	450,000	4.8
Phillip Securities (UK) Nominees	299,588	3.2

Corporate Governance
Surface Transforms plc is committed to maintaining high standards of corporate governance. The company complies with the Combined Code as modified by the recommendations of the Quoted Companies Alliance to the extent the directors consider appropriate, given the size of the company, its current stage of development and the constitution of the Board.

The Board has appointed an Audit Committee whose primary role is to review the company's interim and annual financial statements before submission to the Board for approval. The Board has also appointed a Remuneration Committee, which is responsible for reviewing executive remuneration and performance. Both the Audit Committee and Remuneration Committee are made up of two non executive directors. The Audit Committee is currently composed of Peter Holland and Kevin D'Silva, prior to their appointment as non executive directors the committee was composed of Derek Whitney and David Williams. Details of the Remuneration Committee are disclosed in the Report on directors' remuneration on page 8.

Auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the reappointment of KPMG Audit Plc as auditors of the company is proposed at the forthcoming Annual General Meeting.

Annual General Meeting

The Annual General Meeting will be held at KPMG, St James Square Manchester, M2 6DS on 14 October 2003 at 11am.

At the Meeting, in accordance with Directors' Remuneration Report Regulations 2002 and as special business, resolutions will be proposed to renew the directors' general authority to allot un-issued shares in the Company, allot shares for cash free from the pre-emption restrictions set out in the Companies Act 1985.

Resolution 7 will renew the directors' authority to allot unissued shares in the Company in accordance with section 80 of the Companies Act 1985. The resolution authorised the directors to allot shares up to an aggregate nominal amount of £30,954 (being one third of the issued share capital of the Company at the date of this notice). The authority will expire at the conclusion of the next Annual General Meeting of the Company or on the day 15 months from the date of the passing of this resolution (whichever is earlier). The directors have no immediate intention to exercise this authority other than in connection with the group's employee share scheme.

Under section 89 Companies Act 1985, equity securities in the Company may not be allotted for cash (otherwise than in respect of an employee share scheme) without first being offered pro rata to existing shareholders, unless the prior approval o the shareholders is given in a general meeting. The directors consider that it is in the best interests of the Company to renew the relevant authority given at the annual general meeting in 2002. Accordingly, a Special Resolution to this effect is proposed at s Resolution 8 in the notice of Annual general Meeting. The proposed authority will expire at the conclusion of the next Annual General Meeting of the Company or on the day 15 months from the date of passing of this resolution (whichever is earlier) and permits the directors during this period to issue up to an aggregate amount of £9,378 (representing 10% of the issued share capital at the date of this Report) without first offering them to existing shareholders.

All of the above resolutions are set out in the notice of Annual General Meeting.

By order of the board

D Whitney
Chairman
Surface Transforms plc
Trinity Court, 16 John Dalton Street
Manchester M60 8HS

Report on directors' remuneration

Policy on executive director remuneration

For part of the year the Remuneration Committee was comprised of Derek Whitney and Professor David Clark. Following the appointment of two additional non executive directors during the year, the Remuneration Committee is now comprised of Kevin D'Silva and Peter Holland.

The Remuneration Committee is responsible for reviewing and determining the company's policy on executive remuneration (including the grant of options under the Share Option Scheme) and ensuring compliance with and implementation by the company, as far as reasonably practicable, the recommendations and guidelines of the Combined Code. Executive remuneration packages are designed to ensure the company's executive directors and senior executives are fairly rewarded for their individual contributions to the company.

Fees for non executive directors

The fees for non executive directors are determined by the Board. The non executive directors are not involved in the decisions about their own remuneration.

Directors' remuneration – Audited

A summary of the fees and emoluments received by all directors during the year, or (where applicable) period of office follows.

	2003 Total salaries and fees	2002 Salaries and fees	2002 Pension contributions	Total 2002
	£	£	£	£
Executive directors				
JJ Faria	47,934	43,979	-	43,939
DE Levis	49,323	46,776	-	46,776
Dr G Gould	33,816	30,500	-	30,500
Non executive directors				
Professor DT Clark	4,443	9,150	-	9,150
DM Whitney	27,450	6,000	-	6,000
D Williams	2,355	15,975	560	16,535
PJ Holland	-	-	-	-
K D'Silva	-	-	-	-

No pension contributions were paid on behalf of directors in the year ended 31 May 2003

None of the directors received any remuneration or benefits under long-term incentive schemes.

Directors' interests

Details of any contracts in which a director has a material interest are disclosed in note 22.

Share options - Audited
The company operates a share incentive scheme, all options are granted at the discretion of the Board. The options granted, date of grant, exercise price and exercise periods under the scheme are set out below. During the year options to the directors and selected employees to purchase ordinary shares were granted at an exercise price of £0.7 each.

None of the directors exercised options during the year.

Enterprise Management Incentive Scheme

Director	Date of Grant	Number of Shares	Exercise Price	Exercise Period	Expiry date
JJ Faria	19/12/02	64,286	£0.7	19/12/05-19/12/12	19/12/12
DE Levis	19/12/02	64,286	£0.7	19/12/05-19/12/12	19/12/12
Dr G Gould	19/12/02	64,286	£0.7	19/12/05-19/12/12	19/12/12

The market price of the shares at 31 May 2003 was £0.2 and during the period varied from £0.9 to £0.14. The market price of the shares from the date of share option grant has varied from £0.7 to £0.14.

By order of the board

D Whitney
Chairman
Surface Transforms plc

Statement of directors' responsibilities
Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

KPMG Audit Plc
St James' Square
Manchester M2 6DS
United Kingdom

Report of the independent auditors to the members of Surface Transforms plc

We have audited the financial statements on pages 12 to 26.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the directors' report and, as described on page 9, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance. We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the company is not disclosed.

We read the other information accompanying the financial statements and consider whether it is consistent with those statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the directors' remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion
In our opinion:

the financial statements give a true and fair view of the state of the company's affairs as at 31 May 2003 and of its loss for the year then ended; and

the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc 8 September 2003
Chartered Accountants
Registered Auditor

Profit and loss account
for the year ended 31 May 2003

	Note	**2003 Before exceptional items £**	**2003 Exceptional items (see note 5) £**	**2003 After exceptional items £**	2002 As restated (see note 1) £
Turnover	*2*	**239,755**	-	**239,755**	104,063
Cost of sales	*5*	**(105,814)**	**(293,048)**	**(398,862)**	218,120
Gross profit		**133,941**	**(293,048)**	**(159,107)**	322,183
Distribution costs		**(2,552)**	-	**(2,552)**	(12,043)
Administrative expenses before development costs		**(617,644)**	-	**(617,644)**	(409,271)
Development costs		**(350,606)**	-	**(350,606)**	(479,902)
Other operating income	*3*	-	-	-	10,000
Operating loss		**(836,861)**	**(293,048)**	**(1,129,909)**	(569,033)
Interest receivable and similar income	*8*			**6,677**	7,968
Loss on ordinary activities before taxation	*2-8*			**(1,123,232)**	(561,065)
Tax on loss on ordinary activities	*9*			**158,850**	-
Loss on ordinary activities after taxation and for the financial year				**(964,382)**	(561,065)
Loss per ordinary share					
Basic and diluted	*23*			**(10.86p)**	(7.5p)

All amounts relate to continuing activities.

Balance sheet
at 31 May 2003

	Note		2003		2002
		£	**£**	£	£
Fixed assets					
Intangible assets	*10*		**10,758**		12,976
Tangible assets	*11*		**97,893**		130,376
			108,651		143,352
Current assets					
Stocks	*12*	**70,068**		338,171	
Debtors	*13*	**294,387**		76,834	
Cash at bank and in hand		**178,175**		139,595	
		542,630		554,600	
Creditors: amounts falling due within one year	*14*	**(77,608)**		(118,442)	
Net current assets			**465,022**		436,158
Net assets			**573,673**		579,510
Capital and reserves					
Called up share capital	*16*		**93,799**		79,156
Share premium account	*17*		**1,967,775**		1,023,873
Other reserves	*17*		**520,399**		520,399
Profit and loss account	*17*		**(2,008,300)**		(1,043,918)
Equity shareholder's funds			**573,673**		579,510

These financial statements were approved by the board of directors on 8 September 2003 and were signed on its behalf by:

JJ Faria
Director

Cash flow statement
for the year ended 31 May 2003

	Note	2003 £	2002 £
Reconciliation of operating loss to net cash flow from operating activities			
Operating loss		**(1,129,909)**	(569,033)
Depreciation charge		**41,628**	38,886
Amortisation charge		**2,218**	2,224
Profit on sale of fixed assets		**(100)**	-
Decrease/(increase) in stocks		**268,103**	(300,269)
Increase in debtors		**(58,703)**	(3,724)
(Decrease)/increase in creditors		**(40,834)**	63,036
Net cash outflow from operating activities		**(917,597)**	(768,880)

Cash flow statement

	Note	2003 £	2002 £
Cash flow from operating activities		**(917,597)**	(768,880)
Return on investments and servicing of finance	*20*	**6,677**	7,968
Taxation		**-**	-
Capital expenditure	*20*	**(9,045)**	(52,737)
Cash outflow before financing		**(919,965)**	(813,649)
Financing	*20*	**958,545**	592,852
Increase/(decrease) in cash in the period	*20*	**38,580**	(220,797)

Reconciliation of net cash flow to movement in net funds

	Note	2003 £	2002 £
Increase/(decrease) in cash in the period		**38,580**	(220,797)
Change in net funds resulting from cash flows		**38,580**	(220,797)
Movement in net funds in the period		**38,580**	(220,797)
Net funds at the start of the period	*21*	**139,595**	360,392
Net funds at the end of the period	*21*	**178,175**	139,595

Statement of total recognised gains and losses
for the year ended 31 May 2003

	Note	**2003**	2002
		£	£
Loss for the financial year		**(964,382)**	(561,065)
Total recognised gains and losses relating to the financial year		**(964,382)**	(561,065)
Prior year adjustment	4	**-**	(134,317)
Total gains and losses recognised since last annual report		**(964,382)**	(695,382)

Reconciliation of movements in shareholders' funds
for the year ended 31 May 2003

	2003	2002
	£	£
Loss for the financial year	**(964,382)**	(561,065)
New share capital subscribed (net issue of costs)	**958,545**	592,852
Net (reduction in)/addition to shareholders' funds	**(5,837)**	31,787
Opening shareholders' funds	**579,510**	547,723
Closing shareholders' funds	**573,673**	579,510

Notes
(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company's financial statements except as noted below. The company has adopted FRS 18 'Accounting policies' and FRS 19 'Deferred tax' in these financial statements.

Change in format of profit and loss account

In accordance with FRS 18 ' Accounting policies' the directors decided to change the format of the profit and loss account to separately highlight development expenses. The directors believe this provides a better understanding of the company's activities in the year. Cost of sales, administrative expenses and development expenses have all been reclassified. The change in format has resulted in no change to operating loss in either year.

Basis of preparation
The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules.

Intangible fixed assets and amortisation
Expenditure on patents is capitalised and amortised to nil by equal annual instalments over the useful economic life of seven and a half years.

Fixed assets and depreciation
Depreciation is provided to write off the cost less the estimated residual value of tangible fixed assets by equal instalments over their estimated useful economic lives as follows:

Plant and machinery	-	20% per annum
Fixtures and fittings,	-	25% per annum

Foreign currencies
Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the contracted rate or the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account.

Leases
Operating lease rentals are charged to the profit and loss account on a straight line basis over the period of the lease.

Government Grants
Revenue grants are credited to the profit and loss account, and included within other operating income, so as to match them with expenditure to which they relate.

Post retirement benefits
The company contributes to specific employees personal pension schemes. The amount charged to the profit and loss account represents the contributions payable to employees personal pension schemes during the accounting year.

Employee share schemes
The cost of awards to employees that take the form of shares or rights to shares are recognised over the period of the employees related performance. Where there are no performance criteria the cost is recognised when the employee becomes unconditionally entitled to shares.

Research and development
Expenditure on research and development is written off to the profit and loss account in the year in which it is incurred.

Stocks
Stocks are stated at the lower of cost and net realisable value. In determining the cost of raw materials and consumables the standard purchase price is used. For work in progress, cost is taken as production cost, which includes an appropriate proportion of attributable overheads.

Taxation
The charge for taxation is based on the loss for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised without discounting in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

Cash
Cash, for the purpose of the cash flow statement, comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand.

Turnover
Turnover represents the amounts (excluding value added tax) derived from the provision of goods and services to customers during the year.

2 Analysis of turnover and loss on ordinary activities before taxation

Turnover and loss on ordinary activities before taxation is wholly attributable to the principal activity of the company.

Turnover by destination is analysed as follows:

	2003	2002
	£	£
By geographical market:		
United Kingdom	**237,188**	93,992
Rest of European Community	**2,567**	10,071
	239,755	104,063

Turnover by origin, net assets and profit before interest and tax all relate to the UK.

3 Loss on ordinary activities before taxation

	2003	2002
	£	£
Loss on ordinary activities before taxation is stated		
after charging		
Auditors' remuneration:		
- audit	**12,000**	10,000
- other	**5,000**	2,000
Depreciation of owned tangible fixed assets	**41,628**	38,866
Research and development expenditure	**606,922**	179,640
Amortisation of patents and licences	**2,218**	2,224
Rentals payable under operating leases		
- land and building	**5,288**	6,000
Exchange losses	**-**	22
after crediting		
Profit on sale of fixed assets	**100**	-
Exchange gains	**479**	-
Government grants	**-**	10,000

4 Prior year adjustment

A prior year adjustment was made to the 31 May 2001 financial statements which reduced opening shareholders funds at 1 June 2001 by £134,317. In adopting FRS 18 'Accounting policies' the directors decided to change their accounting policy with respect to research and development costs. Previously expenditure on research was written off but, where appropriate, the cost of research and development projects had been capitalised as an intangible asset and amortised over 10 years; however, this policy has been changed to one of immediate write off.

5 Exceptional items

Following Formula 1 regulatory changes introduced during the year which restricted the supply of products to that market, the directors decided to terminate all ongoing Formula 1 development. This resulted in a Formula 1 stock write down of £293,048.

6 Remuneration of directors

Full disclosure of directors' emoluments, share options and directors' pension entitlements which form part of the package as well as remuneration, interests and transactions is given in the Report on directors' remuneration on page 8.

7 Staff numbers and costs

The average number of persons employed by the company (including directors) during the year, analysed by category, was as follows:

	Number of employees	
	2003	2002
Directors	**3**	2
Other employees	**12**	11
	15	13

The aggregate payroll costs of these persons were as follows

	2003	2002
	£	£
Wages and salaries	**315,842**	285,340
Social security costs	**30,574**	27,339
Other pension costs`	**2,540**	2,870
	348,956	315,549

8 Other interest receivable

	2003	2002
	£	£
Bank interest receivable	**6,677**	7,968

9 Taxation

Analysis of credit in period

	2003	2002
	£	£
UK corporation tax		
Current tax on income for the period	**-**	-
Research and Development tax repayment	**(158,850)**	-

Details of the unrecognised deferred tax asset are included in note 15.

Factors affecting the tax charge for the current period

The effective rate of tax for the year of nil is lower than the standard rate of corporation tax in the UK of 30% due principally to losses incurred by the company.

The differences are explained below.

	2003	2002
	£	£
Current tax reconciliation		
Loss on ordinary activities before tax	**(1,123,232)**	(561,065)
Current tax at standard rate of 30% (*2002: 30%*)	**(336,970)**	(168,319)
Effects of:		
Expenses not deductible for tax purposes	**450**	1,536
Capital allowances for period in excess of depreciation	**4,496**	(1,960)
Tax losses incurred in the period	**332,024**	168,743
Research and development tax repayment	**(158,850)**	-
Total current tax credit (see above)	**(158,850)**	-

Factors that may affect future tax charges
The effective tax rate in future years is expected to be below the standard rate of corporation tax in the UK due principally to historical losses which have been carried forward.

10 Intangible fixed assets

	Patents & Licences
	£
Cost	
At beginning and end of year	16,637
Amortisation	
At beginning of year	3,661
Charge for year	2,218
At end of year	5,879
Net book value	
At 31 May 2003	**10,758**
At 31 May 2002	12,976

Patent costs are amortised over seven and a half years.

11 Tangible fixed assets

	Plant and Machinery £	Fixtures and fittings £	Totals £
Cost			
At beginning of year	194,088	6,881	200,969
Additions	9,145	-	9,145
Disposals	(85)	-	(85)
At end of year	203,148	6,881	210,029
Depreciation			
At beginning of year	68,134	2,459	70,593
Charge for year	39,908	1,720	41,628
On disposals	(85)	-	(85)
At end of year	107,957	4,179	112,136
Net book value			
At 31 May 2003	**95,191**	**2,702**	**97,893**
At 31 May 2002	125,954	4,422	130,376

12 Stocks

	2003 £	2002 £
Raw materials and consumables	**-**	6,802
Work in progress	**70,068**	331,369
	70,068	338,171

13 Debtors

	2003 £	2002 £
Trade debtors	**125,414**	38,780
Other debtors	**-**	29,792
Prepayments and accrued income	**10,123**	8,262
Research and development tax repayment	**158,850**	-
	294,387	76,834

All debtors fall due within one year.

14 Creditors: amounts falling due within one year

	2003 £	2002 £
Trade creditors	**39,551**	79,029
Taxation and social security	**16,690**	9,622
Other creditors	**-**	444
Accruals and deferred income	**21,367**	29,347
	77,608	118,442

15 Provisions for liabilities and charges

The elements of deferred taxation are as follows:

	2003 £	2002 £
Difference between accumulated depreciation and amortisation and capital allowances	**7,036**	11,215
Tax losses	**(7,036)**	(11,215)
Deferred tax liability	**-**	-

The company has £335,543 of unrecognised deferred tax asset at 31 May 2003 *(2002: £143,587)* relating to tax losses which the company can off set against future taxable profits. An element of historical losses brought forward at 1 June 2002 has been surrendered for tax credit relief to allow the submission of a research and development tax claim. The claim has resulted in the surrender of some historical losses carried forward and a £157,011 reduction in the unrecognised deferred tax asset at 31 May 2002 which was previously disclosed in the 2002 accounts as £300,598.

The deferred tax asset has not been recognised in the accounts because it is not possible to assess whether there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

16 Called up share capital

	2003 £	2002 £
Authorised		
20,000,000 ordinary shares of £0.01 each	**200,000**	200,000
Allotted, called up and fully paid		
9,379,880 shares of £0.01 each	**93,799**	79,156
(2002: 7,915,623 ordinary shares of £0.01 each)		

On 24 September 2002, the date of admission to the Alternative Investment Market (AIM) of the London Stock Exchange, 1,446,757 ordinary shares were issued. The consideration received in respect of these shares was £1,302,081 before costs of £352,287, being the professional costs associated with the raising of the new share capital and the admission of the company's share capital to trading on the Alternative Investment Market.

All the additional funds were raised in the year to facilitate the ongoing development of the carbon fibre reinforced ceramic friction products.

The new shares issued rank pari passu in all respects with the ordinary shares in issue prior to the company's admission to AIM including the same voting rights, rights to dividends, and their priority and amounts receivable on a winding up.

Warrants
On 4 December 2000, the date of admission to OFEX, 566,667 offer warrants and 615,799 financial arranger warrants were granted to the purchasers of the ordinary shares and the financial adviser respectively. One offer warrant was issued with every three ordinary shares purchased. The financial arranger warrants were issued to the financial adviser in lieu of consultancy fees.

The fair value attributable to the offer and financial arranger warrants were calculated on the date of issue as £212,500 and £307,899 respectively. When the warrants were granted, adjustments were made to reduce the share premium account and increase the warrant reserve in respect of both amounts. The offer warrant reserve, relates to the reduction in consideration received for the shares and the financial arranger warrant reserve relates to issue costs that would have been set off against the share premium account.

When the warrants are exercised the fair value of the warrants is transferred from the warrant reserve to the capital reserve and the premium credited to the share premium account in accordance with FRS 4.

There are 146,770 Offer Warrants remaining *(2002:146,770)* which entitles each holder to subscribe for ordinary shares at a price of £0.7 per ordinary share at any time in the period until three years from 4 December 2000, the date of OFEX admission ('admission date'). The original warrant conditions also entitled each holder to subscribe for ordinary shares at a price of £0.5 in the period from one year from admission date and £0.6 in the period from one year until two years from admission date however these have now lapsed.

There are 466,000 Financial Arranger Warrants remaining *(2002: 483,500)* at a price of £0.5 per ordinary share at any time until three years from the admission date.
None of the warrants hold voting rights.

The Offer Warrants and the Financial Arranger Warrants have been exercised as follows:

	Offer warrants Number	**Arranger warrants** Number	**Share capital** Number
At 31 May 2002	146,770	483,500	7,915,623
Share issue	-	-	1,446,757
Warrants exercised in the year	-	(17,500)	17,500
At 31 May 2003	146,770	466,000	9,379,880

The Financial Arranger Warrants were all exercised at £0.5 in the year ended 31 May 2003. The consideration received was £8,750.

Enterprise Management Incentive Scheme
The company operates a share incentive scheme for the benefit of the directors and certain employees. All options are granted at the discretion of the Board. The scheme grants options to purchase ordinary shares of £0.01 each. No options were exercised in the period.

The options granted to directors, date of grant and exercise price and exercise periods under scheme are set out in the Report on directors remuneration on page 8. In addition to the directors share options certain employees have been granted the following options:

	Number	**Exercise price**	**Exercise period**
EMI scheme	149,233	£0.7	19/12/05-19/12/12

17 Reserves

	Share premium account £	**Warrant reserve** £	**Capital reserve** £	**Profit and loss account** £
At beginning of year	1,023,873	296,789	223,610	(1,043,918)
Premium on issue of shares	1,287,614	-	-	-
Premium on exercise of warrants	8,575	-	-	-
Transfer on exercise of warrants	-	(17,500)	17,500	-
Issue costs	(352,287)	-	-	-
Retained loss for the year	-	-	-	(964,382)
At end of year	1,967,775	279,289	241,110	(2,008,300)

18 Commitments

Annual commitments under non-cancellable operating leases are as follows:

	Land and Buildings 2003 £	Land and Buildings 2002 £
Operating leases which expire:		
In the second to fifth years inclusive	5,288	6,000
	5,288	6,000

19 Pension scheme

The company operates a defined contribution pension scheme. The pension cost charge for the year represents contributions payable by the company to the scheme and amounted to £2,540 *(2002: £2,870)*.

There were no outstanding or prepaid contributions either at the beginning or end of the financial year.

20 Analysis of cash flows

	2003 £	**2002 £**
Returns on investments and servicing of finance		
Interest received	**6,677**	7,968
Capital expenditure and financial investment		
Purchase of intangible assets	**-**	(5,856)
Purchase of tangible fixed assets	**(9,145)**	(46,881)
Sales of tangible fixed assets	**100**	
	(9,045)	(52,737)
Financing		
Issue of ordinary share capital	**14,643**	7,707
Premium from issue of ordinary share capital (net of issue costs)	**935,327**	371,318
Premium on exercise of warrants	**8,575**	213,827
	958,545	592,852

21 Analysis of changes in net funds

	At beginning of year £	**Cash flow £**	**At end of year £**
Cash at bank and in hand	139,595	38,580	178,175

22 Related party disclosures

The results of the company include the following transactions with related parties:

Company/entity	Relationship	Purchase	2003 £	2002 £
April Training Executive	JJ Faria is a director and has a controlling interest	Administrative services	**10,705**	21,279
April Property Partnership	JJ Faria is a director and has a controlling interest	Rent	**5,288**	6,000

All purchases from related parties are conducted on an arms length basis under normal commercial trading terms.

At the year end no amounts were owing in respect of April Training Executive *(2002: £781)* or April Property Partnership *(2002: £nil)*.

23 Loss on ordinary shares

The calculation of basic loss per ordinary share is based on the loss for the financial year divided by the
weighted average number of shares in issue during the year.

Losses and number of shares used in the calculations of loss per ordinary share are set out as follows:

Basic

	2003 £	2002 £
Loss after tax	**(964,382)**	(561,065)
Weighted average number of shares	**8,882,861**	7,515,251
Loss per share	**10.86p**	7.5p

The calculation of diluted loss per ordinary share is identical to that used for the basic loss per ordinary share. This is because the exercise of warrants and options would have the effect of reducing the loss per ordinary share and is therefore not dilutative under the terms of FRS 14.

Company information and advisors

Registered Number	03769702
Directors	Derek Martin Whitney (Non executive Chairman) Julio Joseph Faria (Managing Director) David Edward Levis (Commercial Director) Geoffrey Gould (Sales and Marketing Director) Professor David Thomas Clark (Non executive Director) Kevin D'Silva (Non executive Director) Peter Holland (Non executive Director)
Company Secretary	Hammonds Secretaries Limited 7 Devonshire Square, Cutlers Gardens, London EC2M 4YH
Registered office	Trinity Court 16 John Dalton Street, Manchester M60 8HS
Head office	April House, Tarvin Road, Frodsham, Cheshire WA6 6XN
Nominated adviser and broker	Brewin Dolphin Securities Limited 34 Lisbon Street, Leeds LS1 4LX
Auditors	KPMG Audit Plc, St James' Square, Manchester M2 6DS
Solicitors to the Company	Hammonds Trinity Court, 16 John Dalton Street, Manchester M60 8HS
Bankers	Barclays Bank plc 125 Main Street, Frodsham, Cheshire WA6 7AD
Financial Advisor	Leob Aron & Company Limited Georgian House, 63 Coleman Street, London EC2R 5BB
Registrars	Capita IRG plc Bourne House, 34 Beckenham Road, Beckenham, Kent BR3 4TU
Financial public relations advisers	Gresham PR 4 Bloomsbury Square, Bloomsbury House, London WC1A 2RP